BANCA ALETTI
GRUPPO BANCO POPOLARE

Global Economy Report

November-December 2014

European University Institute
ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

GLOBAL GOVERNANCE Programme

Global Economy Report

The Global Economy Report is prepared in cooperation by the Macroeconomic Research Division of Banca Aletti and the Global Governance Programme of the Robert Schuman Centre for Advanced Studies of the European University Institute.

The objective of the Report is to provide an analysis of the current and expected macroeconomic and financial conditions at the global level, with also a focus on key economic areas such as Europe, the USA and ASIA.

This report has been prepared by:

- Daniele Limonta (daniele.limonta@alettibank.it)
- Massimiliano Marcellino (massimiliano.marcellino@eui.eu)
- Alessandro Stanzini (alessandro.stanzini@alettibank.it)
- Maria Eleonora Traverso (mariaeleonora.traverso@alettibank.it)

with the collaboration of:
- Alberta Martino (alberta.martino@eui.eu)

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EXECUTIVE SUMMARY

- In its latest Economic Outlook, the OECD expects a moderate global growth: 3.7% in 2015 and 3.9% in 2016, slightly above the 3.3% value for 2014.

- The 2014 global growth value is decomposed into the contribution of emerging countries (4.8%, down from 5% in 2013) and that of developed economies (1.8%, also down from 1.4%). The slightly higher growth in 2015 should be due to growth above 2% for the emerging countries and above 2% for the developed ones.

- Among developed countries, the US, UK and Canada are expected to perform well, much better than Japan and euro area. Among emerging countries, China's growth should further slow down; India, Indonesia and South Africa should accelerate; Brazil and Russia will have serious problems.

- There remain downward risks for current and future global growth, due to financial uncertainty, negative expectations, high level of private debt, and some remaining problems in the banking sector.

EXECUTIVE SUMMARY

❖ In Q3, the US economy grew beyond expectations, confirming the global economic cycle's modest influence on domestic economy. GDP grew by 3.9% in annualised terms, with a different mix of growth factors compared to the previous period, based on positive contributions from foreign trade and public spending, that compensated a lower internal demand. Our forecasts for a 3% annualised growth in Q4.

❖ The system presents a vast set of favourable conditions for strengthening domestic demand. Business investments are needed to support growth in production, with business confidence at the highest level of the past three years. On the other hand, the continuing improvement of working conditions and the drop in fuel prices are the basis for stronger private consumption.

❖ For 2014, we forecast an average growth rate of 2.3%, up one tenth on previous estimates as an effect of robust performance in Q3-14 and of the recent data flow often above expectations. For 2015 we assume a consolidation at 3.1%, with upward revision risk. These values are broadly in line with those from the OECD and IMF.

EXECUTIVE SUMMARY

❖ The general inflation rate in the US remains well under 2%, with a tendency to further decrease due to negative pressures from declining energy prices. In the central scenario, it will reach a minimum at 1.2% in the second quarter of 2015. Core inflation will remain constantly higher and – without significantly dropping under current levels- will return above 2% in the summer of next year, triggered by accelerating economic cycle and the first signs of pressure on wages.

❖ As hourly wages remain flat, the increase in working hours is accelerating average weekly wages. Also, the Employment Cost Index, an alternative labour cost measure, is at its highest level in the past years.

❖ The Fed has announced the end of QE3. However, timing for rates' first increase remain uncertain and largely dependant on the strength of labour markets' improvement. We maintain the assumption of restrictive path's beginning in June, with 1.25% by end of 2015, but we foresee an earlier tightening with greater probability.

EXECUTIVE SUMMARY

❖ In Q3 the euro area economy registered a modest growth (+0.2%), however better than expected. The feared recession didn't take place, as the leading indicators' downtrend had instead suggested.

❖ Partly the stronger vigour is due to higher than expected growth in France (+0.3%), openly dystonic towards macroeconomic fundamentals, which are reflected in Germany (+0.1%) and Italy's (-0.1%) performance. Spain, instead, showed a still strong growth rhythm (+0.5%).

❖ This summer's pace seems unsustainable in the last quarter of the year. The indications from surveys point at a basic aggregate income stagnation; our forecast is for a mere 0.1% increase.

❖ The meagre income dynamic in the last part of the year will place a bound on possible 2015 growth, particularly for Germany due to a stronger statistical overhang than euro area average. Income will grow less than one percent all over the area: we expect 0.9% for 2015, slightly less than the OECD and EU Commission (1.1%), and IMF (1.3%).

EXECUTIVE SUMMARY

❖ Aggregate inflation in the euro area was at +0.4% in October, with the flash estimate at 0.3% in November, driven by decrease in energy prices. Core inflation is instead at 0.7% in the final data, touching for the fourth time in less than a year the area's absolute low. Thus, a scenario of long term low inflation persists, but not of a structural and systematic price fall.

❖ We forecast the average inflation rate at 0.5% in 2014 and at +0.9% in 2015, lower than previous estimates, due to stronger-than-forecasted energy price fall.

❖ On the basis of these data, the European Central Bank's budget expansion programme, thus planned, will have very limited effects, failing to bring inflation in line with the ECB's mandate. Thus further expansionary measures will become more likely.

EXECUTIVE SUMMARY

❖ In Q3, Japan experienced a second quarterly contraction, which led the Prime Minister Abe to call early elections, to gain popular support for his economic policy (so called, "Abenomics") and to postpone the second increase in consumption taxes, due in next October.

❖ At the same time, the Central Bank of Japan launched unexpectedly another round of quantitative easing, with the main goal of driving inflation expectations towards the 2% target, even in the presence of substantial downward pressures due to the fall in energy prices.

❖ The Chinese Central Bank also further loosened monetary policy, including a cut in the reference rate, the first since 2012, in order to support growth in the presence of several worrying signals of a slowdown. This is partly due to the needed switch in the growth path, towards a domestic consumption led growth.

❖ Due to their relevance and the recent activity, in this report we focus on the economic conditions in Japan and China.

EXECUTIVE SUMMARY

	2009	2010	2011	2012	2013E	2014E	2015E
GDP (%YOY)							
US	-2.8	2.6	1.6	2.3	2.2	2.3	3.1
EUROZONE	-4.4	2.0	1.4	-0.6	-0.4	0.8	0.9
GERMANY	-5.1	4.2	3.0	0.7	0.4	1.4	0.9
FRANCE	-3.1	1.7	2.0	0.0	0.4	0.4	0.8
ITALY	-5.5	1.8	0.4	-2.4	-1.8	-0.4	0.5
UK	-5.1	1.7	1.1	0.1	1.7	3.1	2.8
JAPAN	-5.5	4.7	-0.6	2.0	1.5	0.3	1.0
BRASIL	-0.3	7.6	2.8	1.0	2.3	0.2	1.1
RUSSIA	-7.8	4.3	4.3	3.4	1.3	0.3	0.6
INDIA	6.4	8.9	7.5	5.1	4.6	5.6	6.4
CHINA	9.2	10.4	9.3	7.7	7.7	7.4	7.0
AUSTRALIA	1.4	2.6	1.4	3.6	2.4	3.1	2.8
KOREA	0.3	6.3	3.6	2.0	2.8	3.5	3.6
INFLATION (%YOY)							
US	-0.4	1.6	3.2	2.1	1.5	1.7	1.5
EUROZONE	0.3	1.6	2.7	2.5	1.4	0.5	0.9
GERMANY	0.2	1.2	2.5	2.1	1.6	0.9	1.4
FRANCE	0.1	1.7	2.3	2.2	1.0	0.6	0.9
ITALY	0.8	1.6	2.9	3.3	1.3	0.2	0.5
UK	2.2	3.3	4.5	2.8	2.6	1.5	1.6
JAPAN	-1.3	-0.7	-0.3	0.0	0.4	2.8	1.5
BRASIL	4.9	5.0	6.6	5.4	6.2	6.3	6.3
RUSSIA	11.7	6.9	8.5	5.1	6.8	7.5	7.0
INDIA	10.8	12.1	8.9	10.4	10.9	7.8	7.5
CHINA	-0.7	3.3	5.4	2.7	2.6	2.1	2.5
AUSTRALIA	1.8	2.9	3.3	1.8	2.4	2.6	2.5
KOREA	2.8	3.0	4.0	2.2	1.3	1.4	2.0

Banca Aletti Forecast

Cons. Bloomberg (Nov 14)

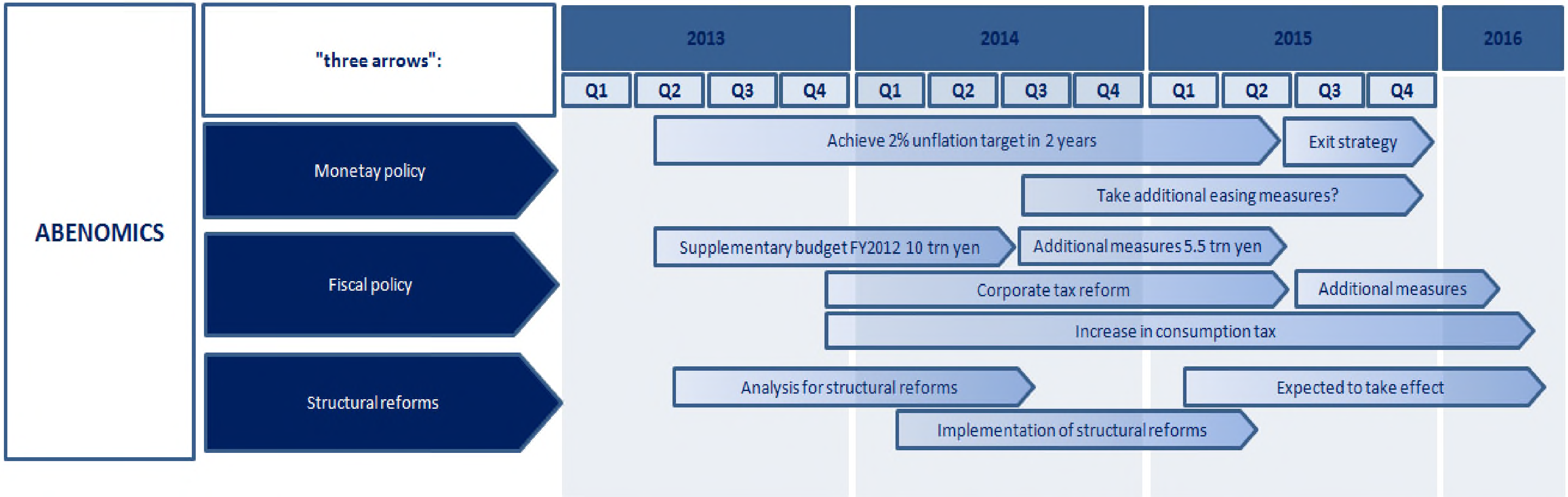
The Japan Outlook

ABENOMICS

Prime Minister Shinzo Abe called early elections, dissolving Parliament November 21, less than two years in advance of the four-year mandate. The Prime Minister, after the negative growth data for Q3, which plunged Japan into recession, wants to check popular consensus on his policies. He stressed that in case his party doesn't win the majority of votes, he would resign. Despite recession, Abe doesn't consider his mix of expansionary monetary and fiscal policies and structural reforms a failure. Elections will probably be on December 14. The second consumption tax hike, scheduled for next October, will be postponed by 18 months

Consumption tax	10% october 2015
	10% april 2017

This restrictive measure, necessary to contain the deficit by 2015, given the amount of debt (240% of GDP), would've hindered growth further, already hit by April's hike, adverse summer weather conditions and the global scenario.

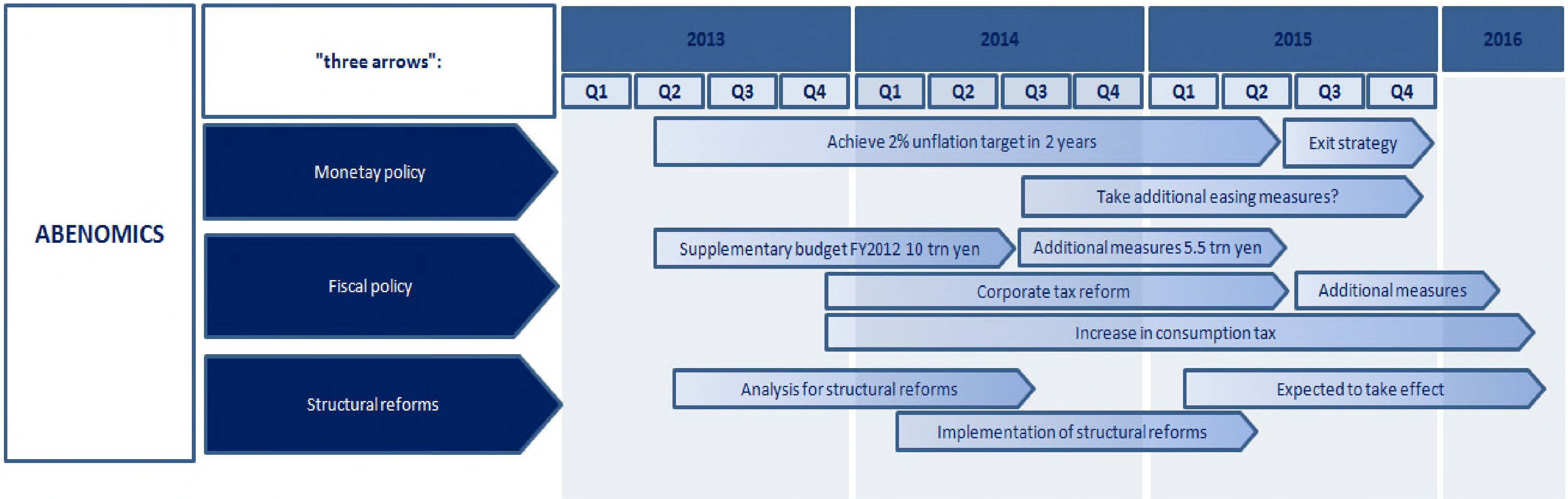


MONETARY POLICY

The Bank of Japan in its October meeting surprised analysts with a package of strongly expansive measures:

- The monetary base will be increased at a rhythm of 80 trillion yen per year, 10-20 more compared to the past
- JGB's acquisitions will be at 80 trillion per year, 30 trillion more than in the past; furthermore maturity will be extended to 7-10 years so to guarantee rates lowering along the whole curve
- ETF and J-REIT acquisitions will be tripled, at an annual amount of 3 trillion and 90 billion yen respectively.

The decision of the monetary policy committee was motivated by fears that inflation forecasts could miss the Central Bank's 2% target, following weakened domestic demand after consumer tax hike and lowering energy prices.



BANK OF JAPAN – BALANCE SHEET

The Bank of Japan forecasts monetary base to reach 275 trillion yen at the end of 2014, with a yearly increase of 80 trillion. In October 2013 the amount of JGB on hand was 130 trillion yen, 142 at the end of 2013 and 184 at the end of October 2014. Forecasts are for year's end target at 200 trillion, with an advance towards the longer side of the curve.

BANK OF JAPAN - Balance Sheet

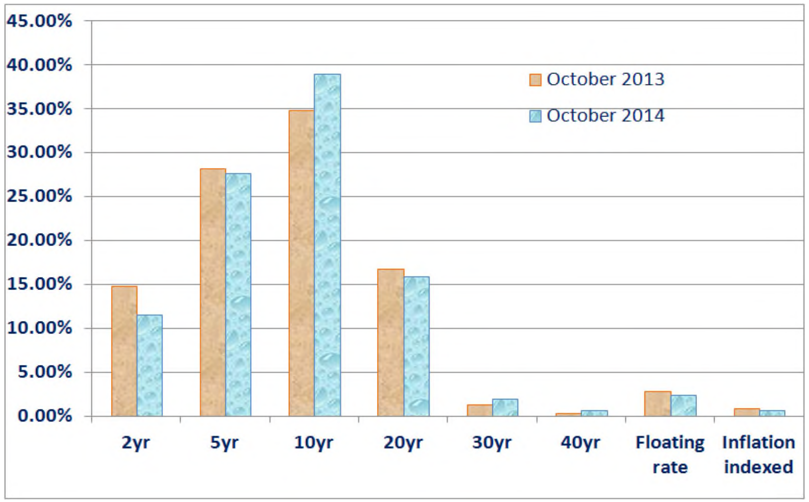
(trillion yen)

	End-2013 (actual)	End-2014 (projected)	The pace of annual increase
Monetary base	202	275	About 80 trillion

Breakdown of the Bank's Balance Sheet

	End-2013 (actual)	End-2014 (projected)	The pace of annual increase
JGBs	142	200	About 80 trillion
CP	2.2	2.2	Maintain the outstanding balance
Corporate bonds	3.2	3.2	Maintain the outstanding balance
ETFs	2.5	3.8	About 3 trillion
J-REITs	0.14	0.18	About 90 billion
Total assets (including others)	224	297	--
Banknotes	90	93	--
Current deposits	107	177	--
Total liabilities and net assets (including others)	224	297	--

Bank of japan	October 2013 Amount Outstanding (Trilioni di yen)	October 2014 Amount Outstanding (Trilioni di yen)
2yr	19	21
5yr	37	51
10yr	46	72
20yr	22	29
30yr	2	4
40yr	0	1
Floating rate	4	5
Inflation indexed	1	1
Totale	**130**	**184**



BANK OF JAPAN - FORECASTS

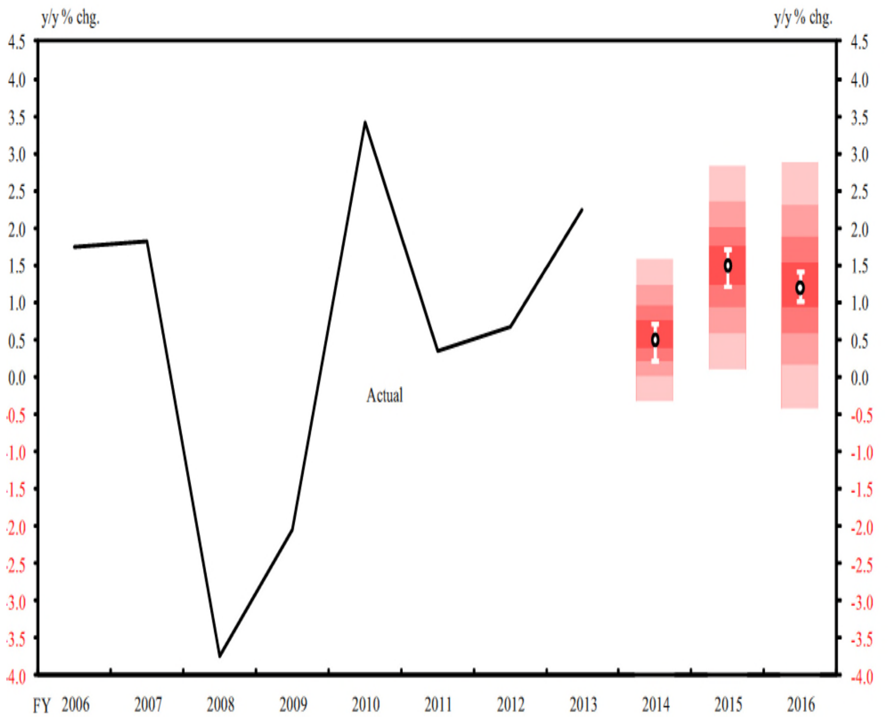
Compared to July forecasts, both growth estimates and inflation trajectory have been lowered, due to weakness in demand.

BANK OF JAPAN: forecasts

y/y % chg.

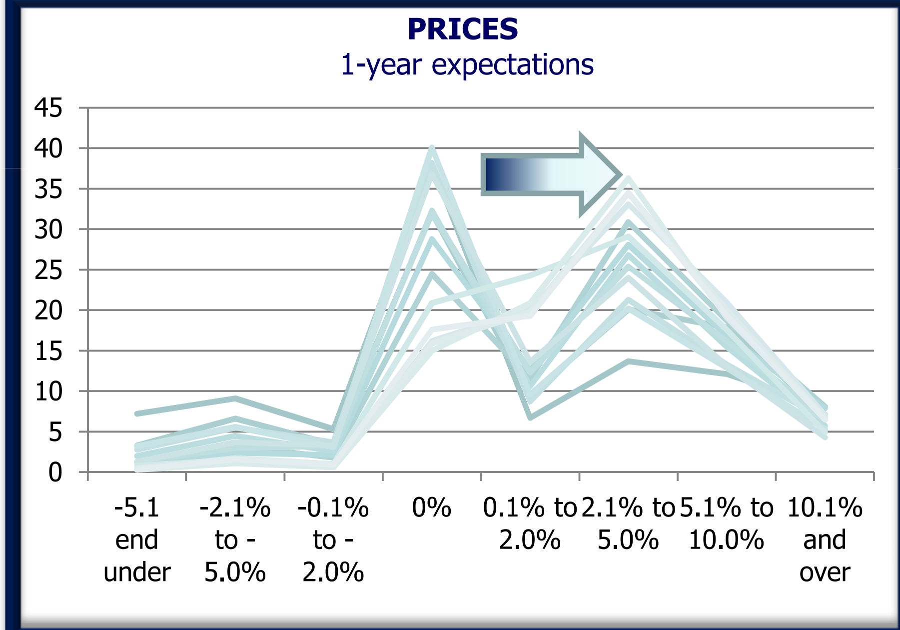
	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2014	+0.2 to +0.7 [+0.5]	+3.1 to +3.4 [+3.2]	+1.1 to +1.4 [+1.2]
Forecasts made in July 2014	+0.6 to +1.3 [+1.0]	+3.2 to +3.5 [+3.3]	+1.2 to +1.5 [+1.3]
Fiscal 2015	+1.2 to +1.7 [+1.5]	+1.8 to +2.6 [+2.4]	+1.1 to +1.9 [+1.7]
Forecasts made in July 2014	+1.2 to +1.6 [+1.5]	+1.9 to +2.8 [+2.6]	+1.2 to +2.1 [+1.9]
Fiscal 2016	+1.0 to +1.4 [+1.2]	+1.9 to +3.0 [+2.8]	+1.2 to +2.3 [+2.1]
Forecasts made in July 2014	+1.0 to +1.5 [+1.3]	+2.0 to +3.0 [+2.8]	+1.3 to +2.3 [+2.1]

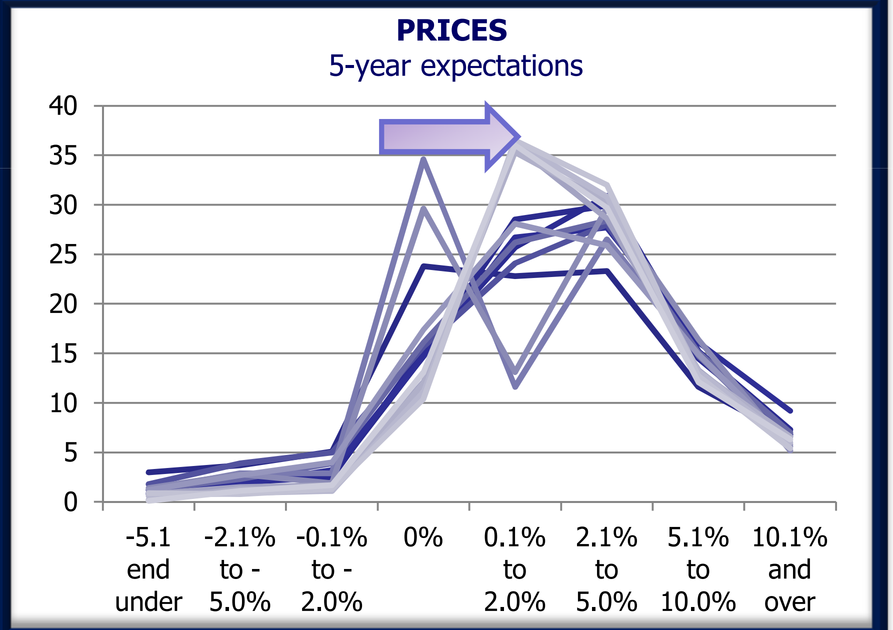
BANK OF JAPAN: inflation forecasts



OPINION SURVEY ON THE GENERAL PUBLIC'S VIEW AND BEHAVIOR

The graphs represent the expectations on 1-year and 5-year inflation in the past two years (the lighter line is the most recent survey). It's clear that short and medium-term expectations are moving toward the Central Bank's target (2%). Thus, Bank of Japan, to support the formation of these expectations has deemed a new expansive manoeuvre necessary. "If the present downward pressure persists, although in the short term, there is a risk that the convergence of inflation consensus towards target, though progressing constantly, may be delayed."

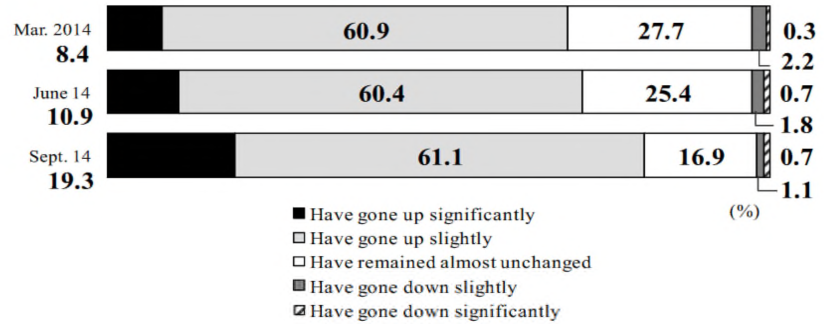




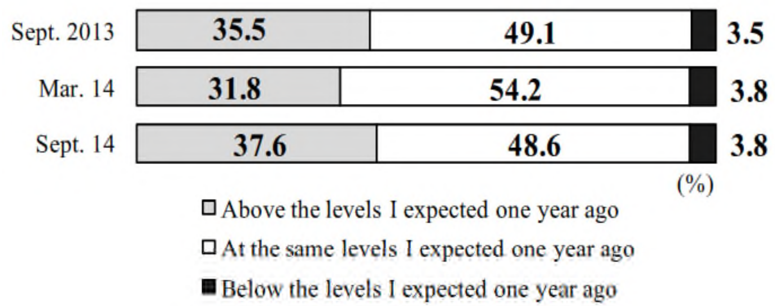
OPINION SURVEY ON THE GENERAL PUBLIC'S VIEW AND BEHAVIOR

The October survey highlighted a strong increase in the percentage of those who noticed a strong price increase since March, before the consumption tax hike (from 8.4% in March to 19.3% in September). 37.6% of those interviewed said prices grew by more than what he expected a year earlier, when Prime Minister Abe announced the taxation hike.

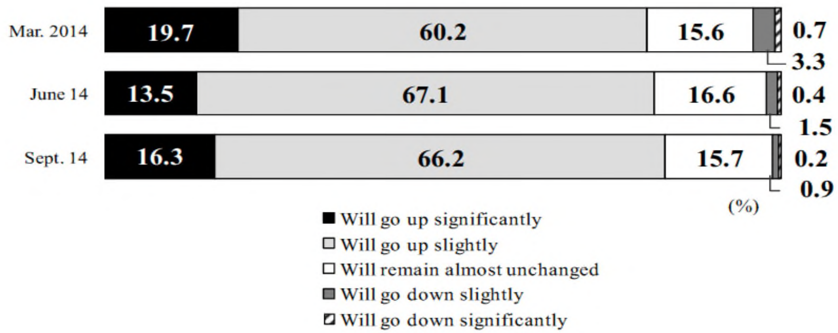
PRICES
perception on current prices



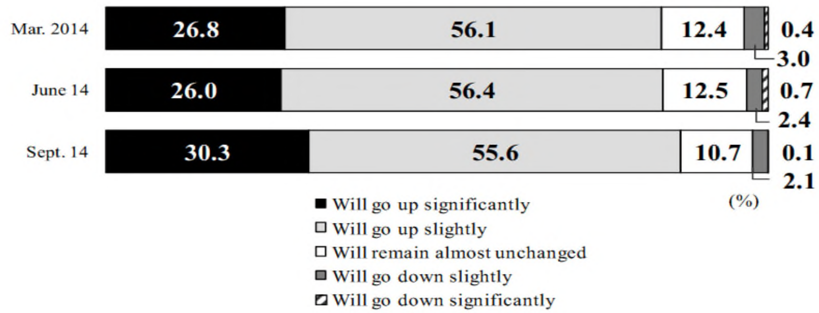
PRICES
Current prices versus levels expected 1 year ago



PRICES
Expectation 1y

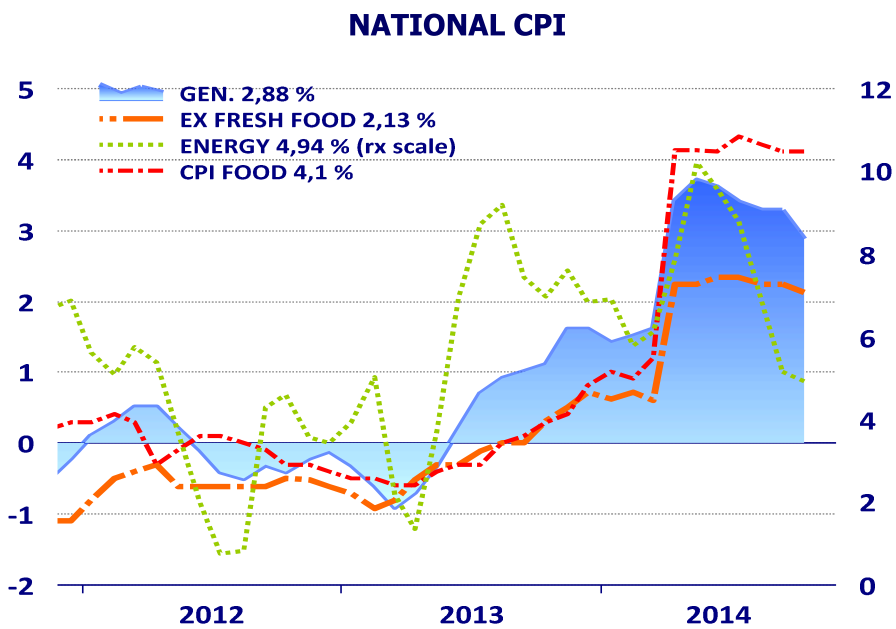


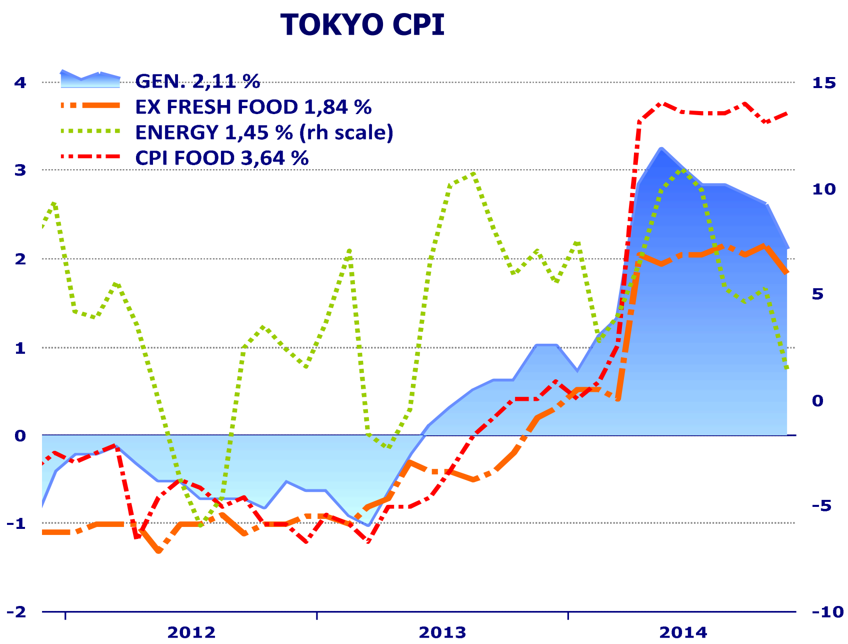
PRICES
Expectation 1y



INFLATION

As to price trends, core inflation decelerated in October from 3.2% to 2.9%, and the core data, i.e. net of food and energy, to 2.2% from 2.3%, while for November expectations are for a new deceleration, as suggested by Tokyo data.

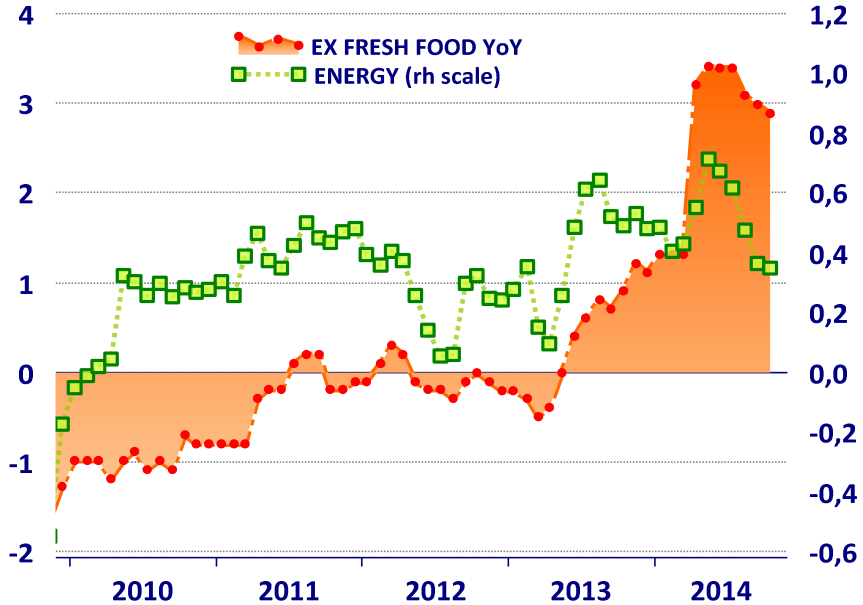




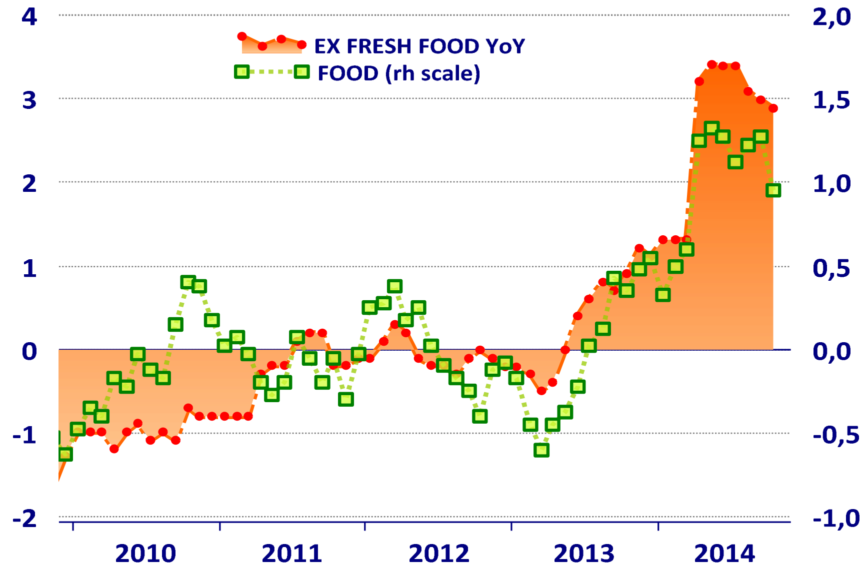
INFLATION

Since the beginning of 2013 the contribution of the energy component has been fundamental to boost inflation. Yen devaluation and the increase in the portion of energy produced from petrol, after 2011's nuclear accident, have contributed to a definite acceleration of the energy component. The effect was then transferred to other productive sectors thus becoming part of a structural phenomenon.

NATIONAL CORE CPI:
Energy component contribution



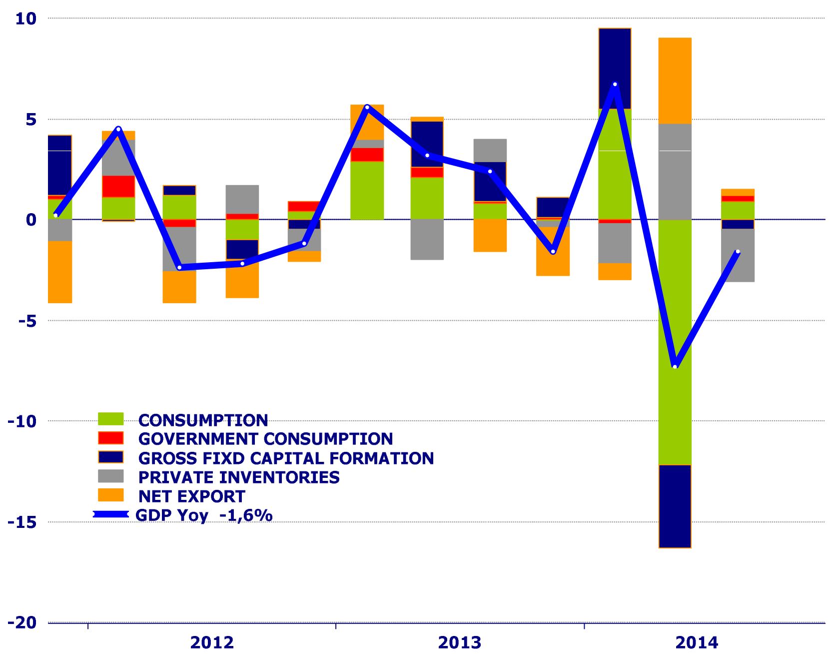
NATIONAL CORE CPI:
food component contribution



GROWTH

The **preliminary growth estimate for Japan for Q3** was at -1.6%, -1.2% annualised, after the strong drop in Q2, thus entering recession. In detail, while in the second quarter the most negative contribution came from consumption, after the added value tax hike, that hit quarterly growth by -3.1%, in Q3 consumption grew, although weakly. In Q3, weakness lies in null non-residential investments, in residential, that eroded 0.2% of GDP and in stock (-0.6%), thus leaving improvement margin for the end of the year. Positive contribution from net export with 0.1%, down from 1.0% in Q2.

GDP contributions

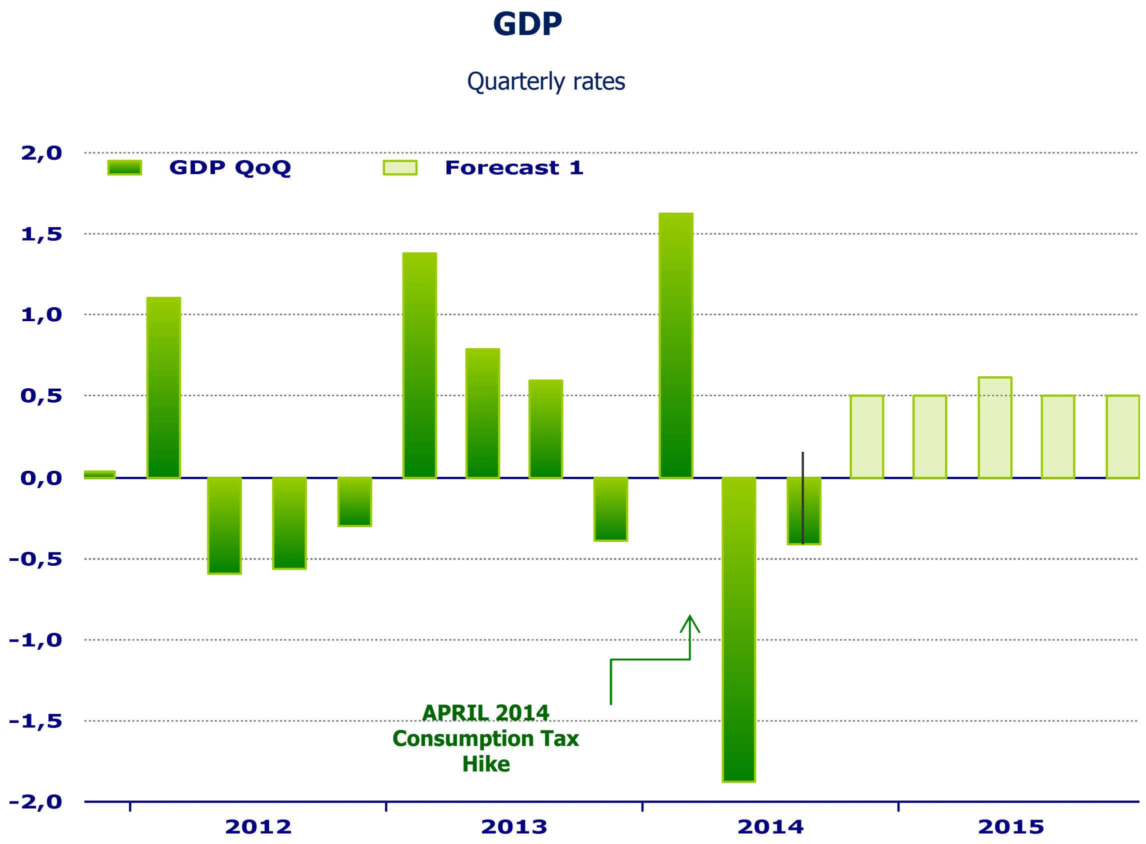


GDP variations

	3Q 2014 QoQ%	3Q 2014 SAAR	3Q 2014 YoY%	Contribution to GDP	2Q 2014 QoQ%	1Q 2014 QoQ%
GDP - real	-0.4%	-1.6%	-1.2%	n/a	-1.9%	1.6%
Domestic demand	-0.5%	-1.9%	-1.5%	-0.5%	-2.8%	1.8%
Private demand	-0.9%	-3.4%	-2.3%	-0.7%	-3.7%	2.5%
Private consumption	0.4%	1.5%	-2.7%	0.2%	-5.0%	2.2%
Household consumption	0.3%	1.4%	-2.8%	0.2%	-5.2%	2.2%
ex-imputed rent	0.4%	1.5%	-3.6%	0.2%	-6.2%	2.6%
Residential investment	-6.7%	-24.1%	-12.3%	-0.2%	-10.0%	2.3%
Capital investment	-0.2%	-0.9%	2.8%	0.0%	-4.8%	7.5%
Private inventories	n/a	n/a	n/a	-0.6%	1.2%	-0.5%
Public Demand	0.7%	2.8%	0.8%	0.2%	0.1%	-0.6%
Government consumption	0.3%	1.3%	0.3%	0.1%	0.0%	-0.2%
Public investment	2.2%	8.9%	2.9%	0.1%	0.3%	-2.0%
Public inventory	n/a	n/a	n/a	0.0%	0.0%	0.0%
Fixed capital formation	-0.6%	-2.2%	0.4%	-0.1%	-4.4%	4.5%
Net Exports	n/a	n/a	n/a	0.1%	1.0%	-0.2%
Exports, goods & services	1.3%	5.3%	7.4%	0.2%	-0.5%	6.4%
Imports, goods & services	0.8%	3.1%	5.0%	-0.2%	-5.4%	6.2%

GROWTH FORECASTS

Growth forecasts have been changed to take into account Q3's growth figure. In the third quarter, GDP fell by 1.6% annualised; estimates for 2014 and 2015 are at +0.3% and at +1.0% respectively and take into account the 7.1% annualised growth decrease in Q2 due to tax hike and domestic demand drop.

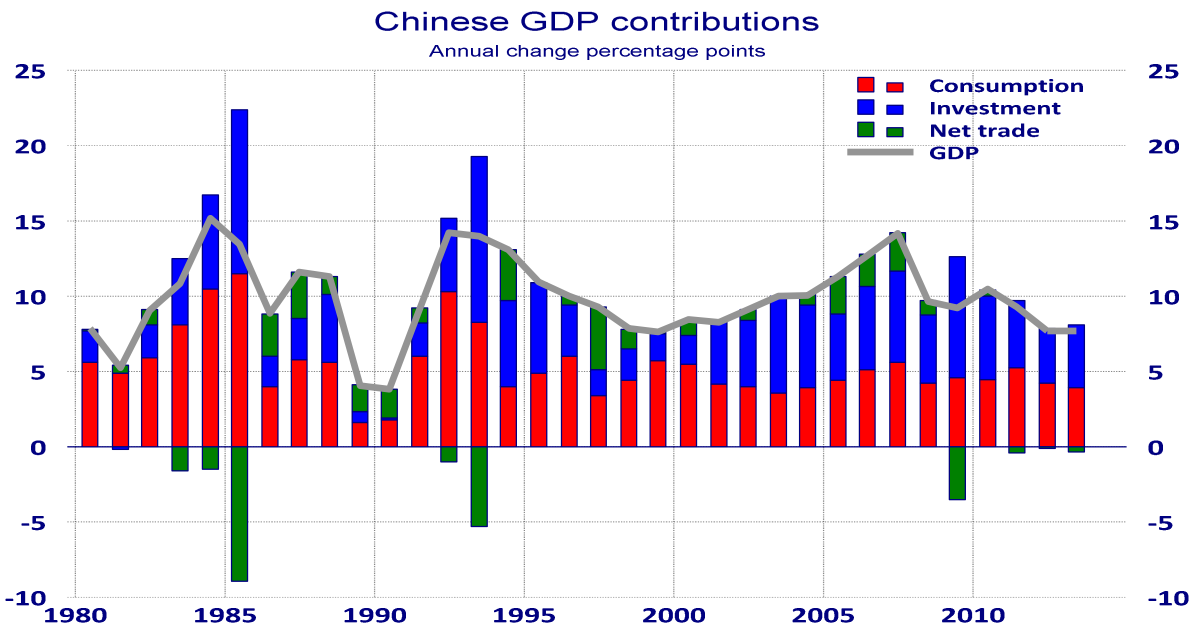


BANCA ALETTI

The China Outlook

GROWTH

In October Chinese data was below consensus, further highlighting the economy's slowdown, due to the change in model from investment-based to consumption-based. Moreover, Q3's growth indicates a slight slowdown compared to Q2 (7.3% YoY from 7.5% YoY), despite the Central Bank's manoeuvres. Consumption continues to give a positive contribution to growth, but investment is penalised by the real estate market and by moderate credit growth. Real estate issues are quite clear, with prices and sales' volumes close to the 2008 and 2012 crises, with signals that let us suppose that this time correction will have a greater impact in terms of volume and duration. As for credit, both local governments and the Central Bank introduced incentives for new mortgages, trying to discourage "shadow banking".



MONETARY POLICY

After the clear slowdown signals, the People's Bank of China (PBoC) has injected great quantities of liquidity in the system…

June

- supplying 1 trl RMB to China Development Bank

September

- through SLF (Standing Lending Facility), that allows to give credit to medium-small financial institutions, 100 bn RMB with a 3-month maturity have been disbursed to the five main banks (Industrial and Commercial Bank of China, Agricultural Bank of China, China Construction Bank, Bank of China and Bank of Communications). The total supplied equals the 25 bp percent cut on reserve requisites.

October

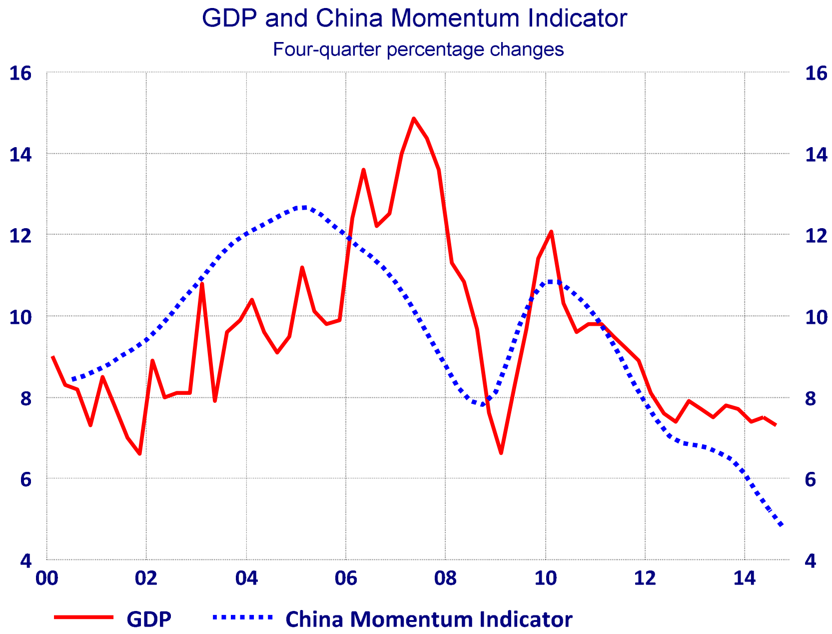
- through MLF (medium term lending facility), a three month refinancing operation for commercial banks, PBoC injected 770 bn RMB into the banking system, equivalent to a 0.5% cut in the reserve coefficient.

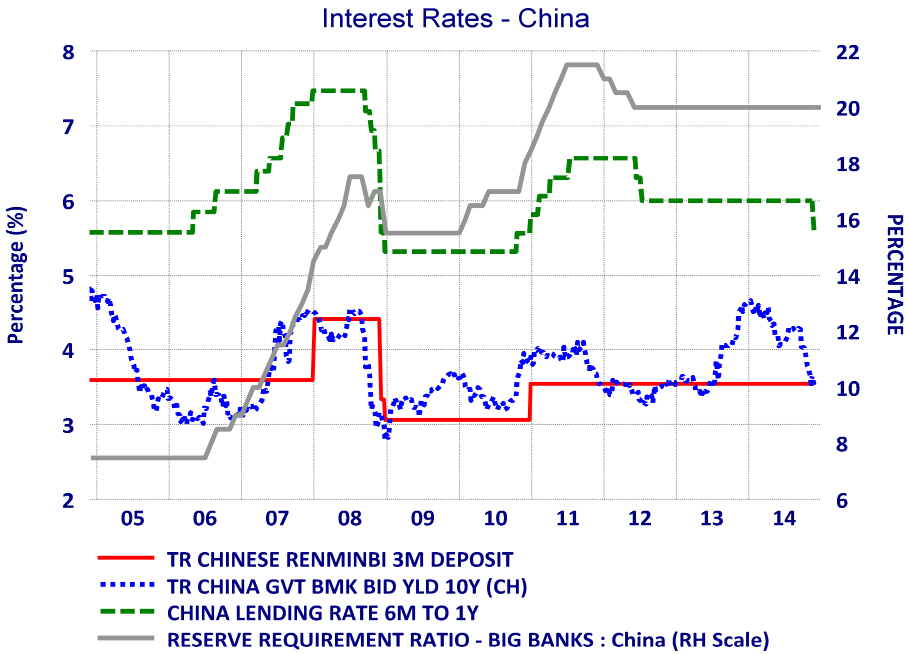
November

- PBoC supplied 50 bn yuan (around 8.2 bn dollars) through short term operations (SLO, Short term Liquidity Operation) to stabilise the monetary market, to offset liquidity shortage that may happen with the planned listing of some companies.

MONETARY POLICY

The People Bank of China has decided to cut reference rates for the first time since 2012, to support the economy, that is giving clear signs of weakness. The expansionary manoeuvre includes a 25 bp cut on the 2.75% 1-year deposits rate, while refinancing rate was reduced by 40 bp to 5.6%.



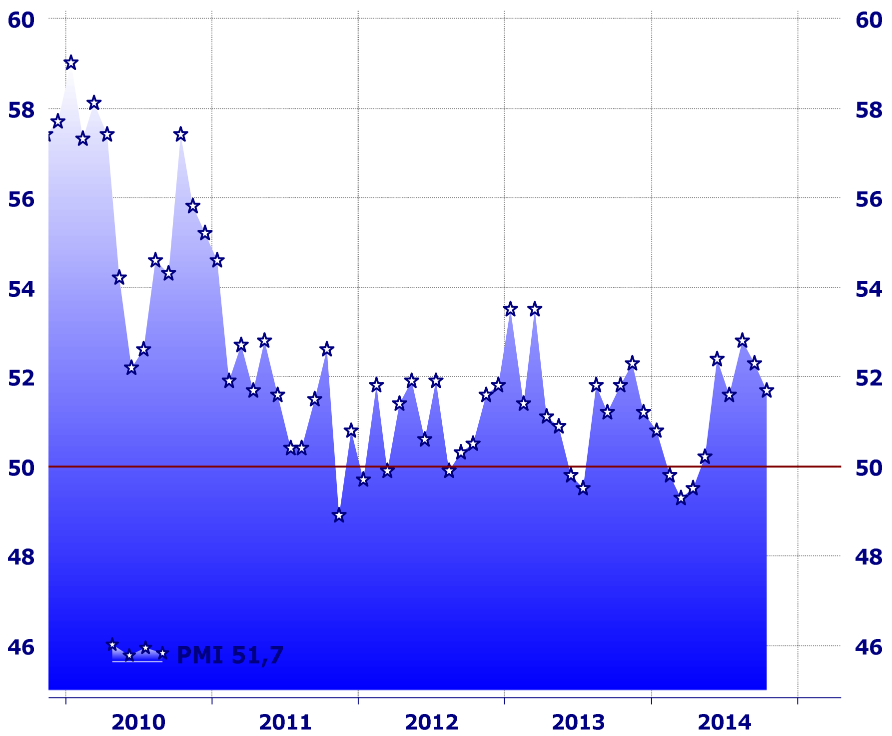


LEADING INDICATORS

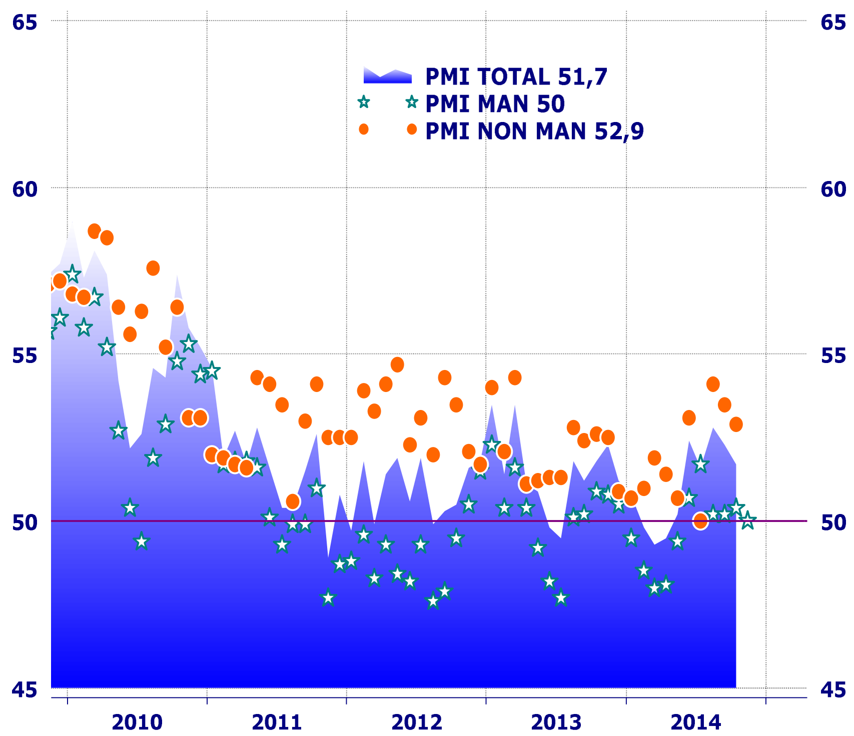
In October China's Composite PMI was at 51.7, signalling a slowdown in goods and services, with the manufacturing index in slight growth at 50.4 and services slowing down again at 52.9. Production slowdown came with a weaker growth also for new orders. The trend for source prices is divergent: for manufacturing, there's a downward pressure, while for services it is growing.

Downstream, prices continue to decrease for both sectors and, in particular for manufacturing, there's been the strongest contraction since March.

COMPOSITE PMI



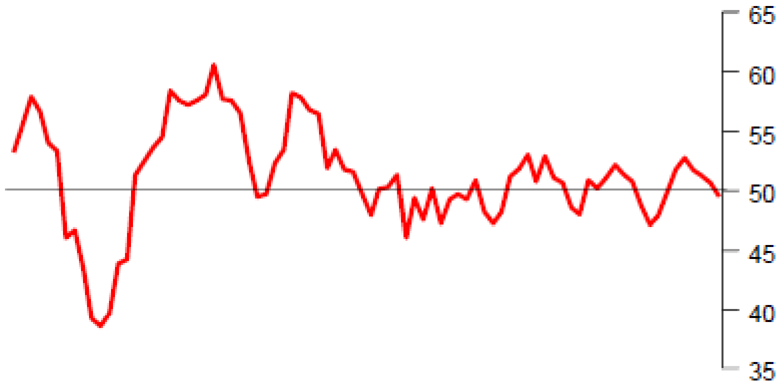
MANUFACTURING AND SERVICES PMI



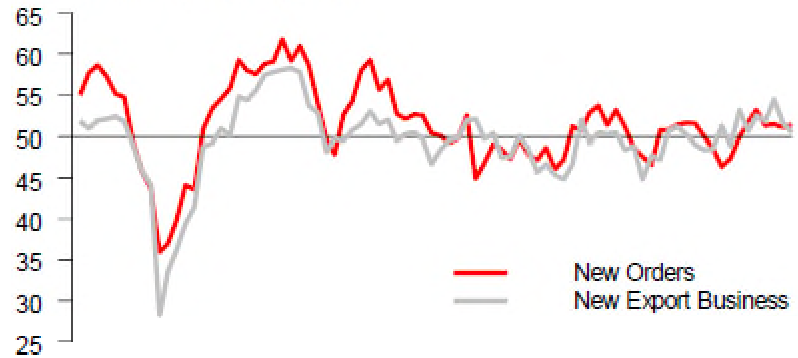
LEADING INDICATORS

China’s Manufacturing PMI in November’s preliminary version was at 50.0, lowest of the past six months, with production index in contraction territory for the first time in seven months (49.5). New orders have accelerated, while those for exports have been weaker. Signs of declining domestic demand lie in the diminished utilised capacities and in negative price pressure.

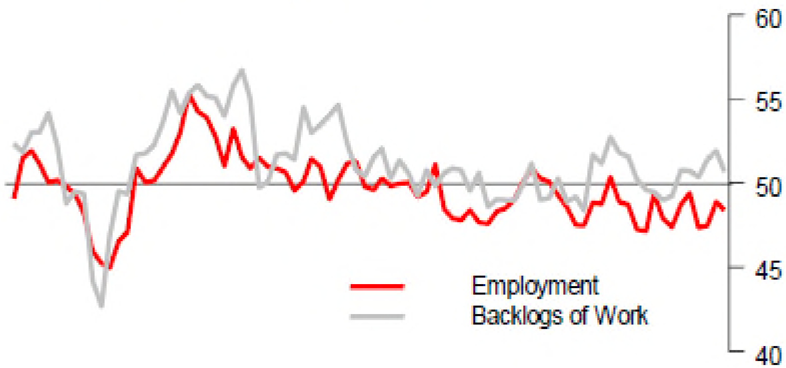
Production



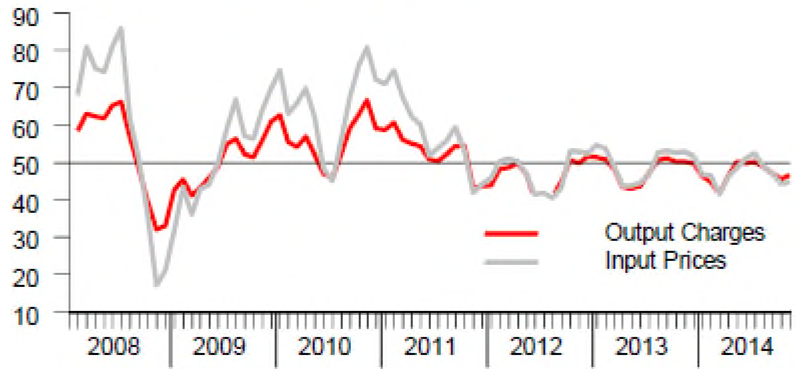
New Orders/Exports



Employment/Backlogs of Work

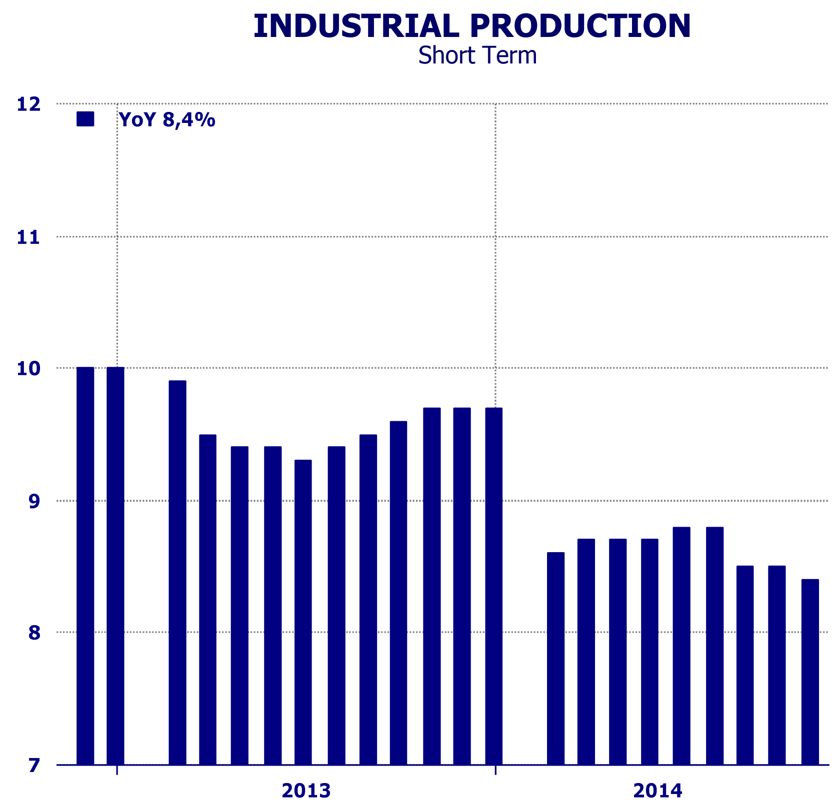


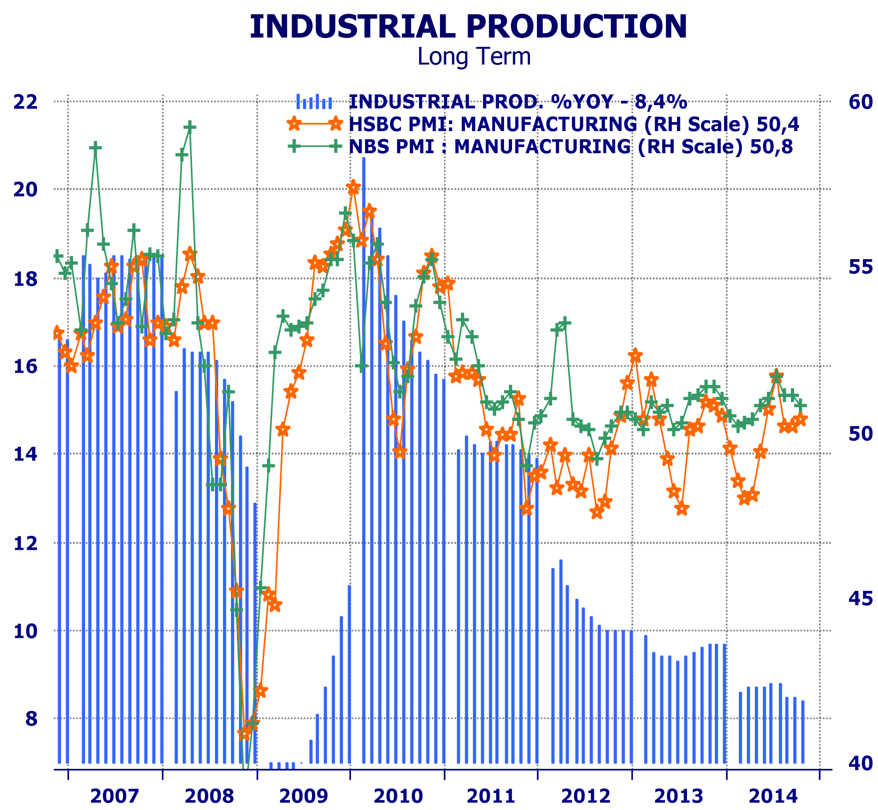
Output Charges/Input Prices



ECONOMIC ACTIVITY

The October survey confirmed the further slowdown of Chinese production, far from its 2010 peak levels.

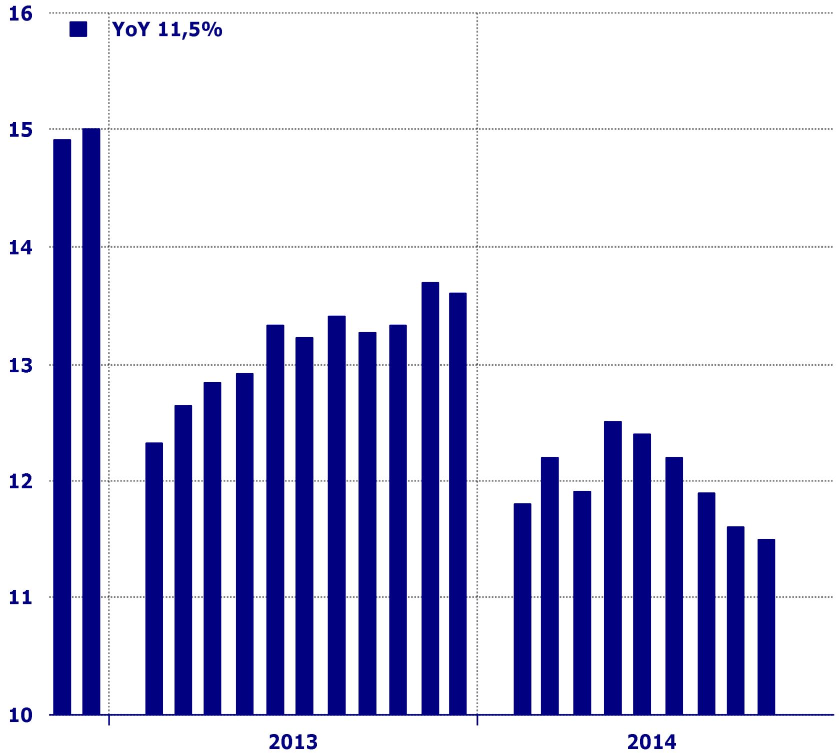




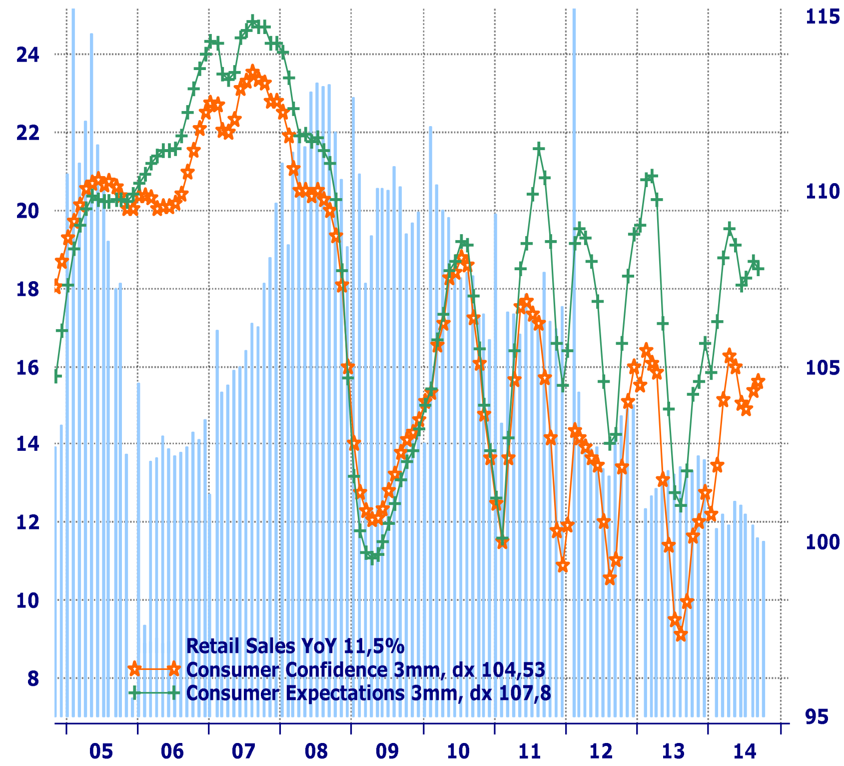
ECONOMIC ACTIVITY

Retail sales' trend dynamics have registered the sixth slowdown in a row, from 11.6% in September to 11.5% in October, lowest since 2006.

RETAIL SALES
Short term

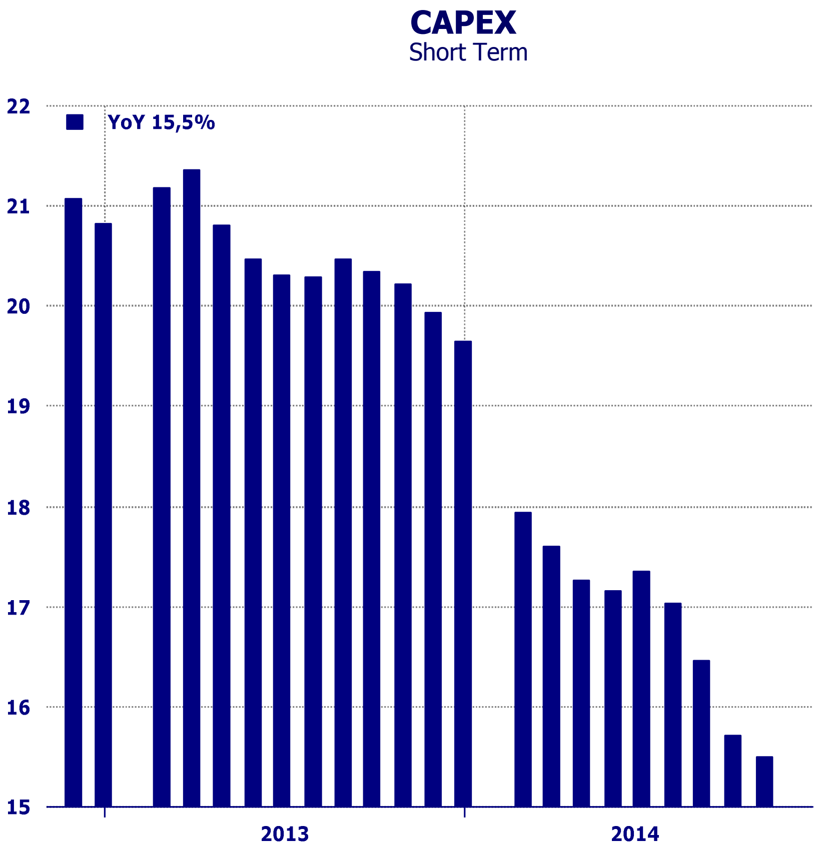


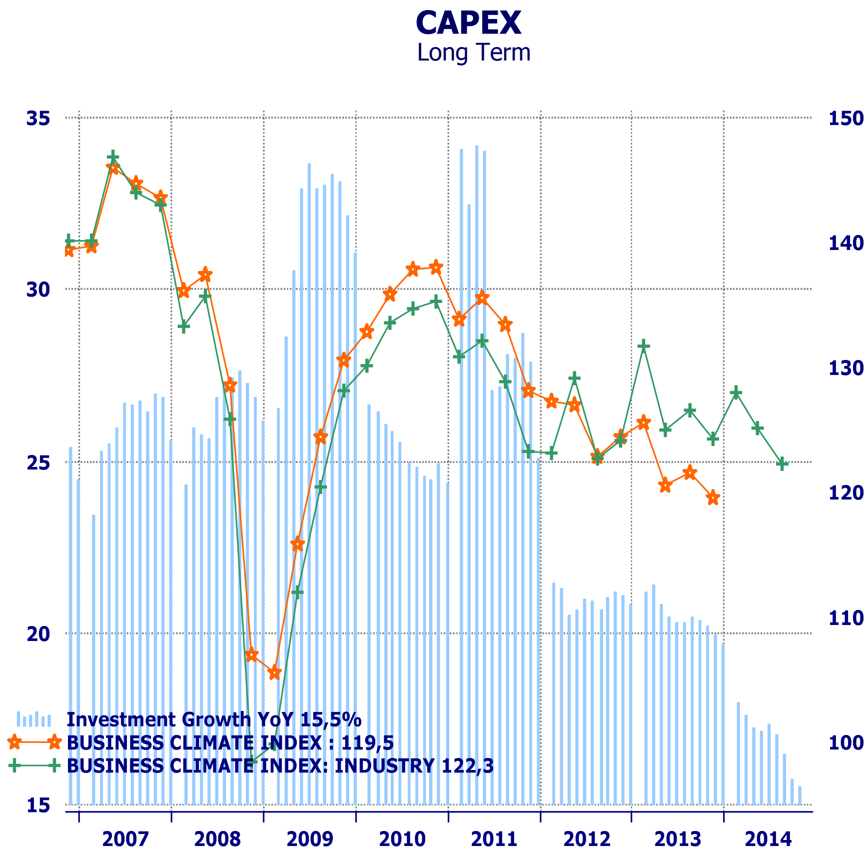
RETAIL SALES
Long term



ECONOMIC ACTIVITY

Capex growth, in line with other macroeconomic indicators, gives a greater than expected image of China's slowdown.

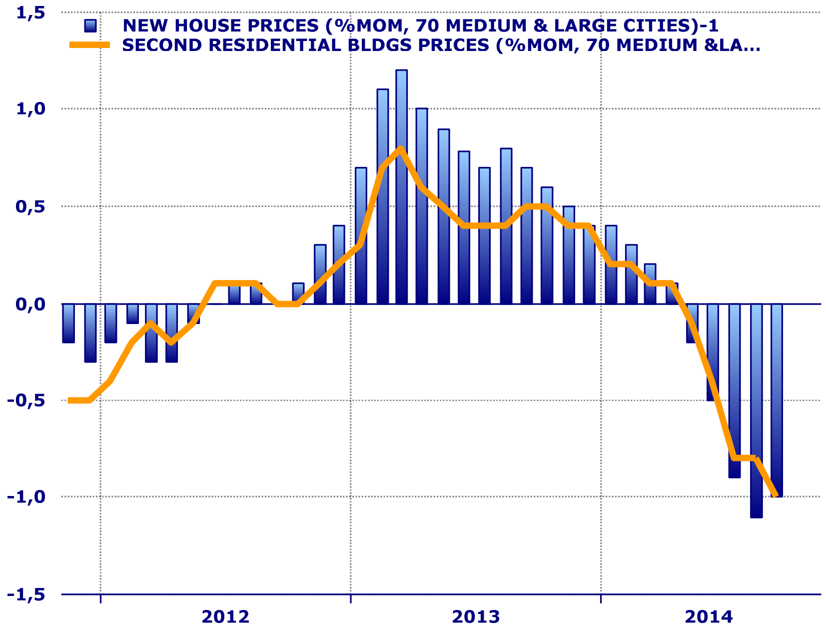




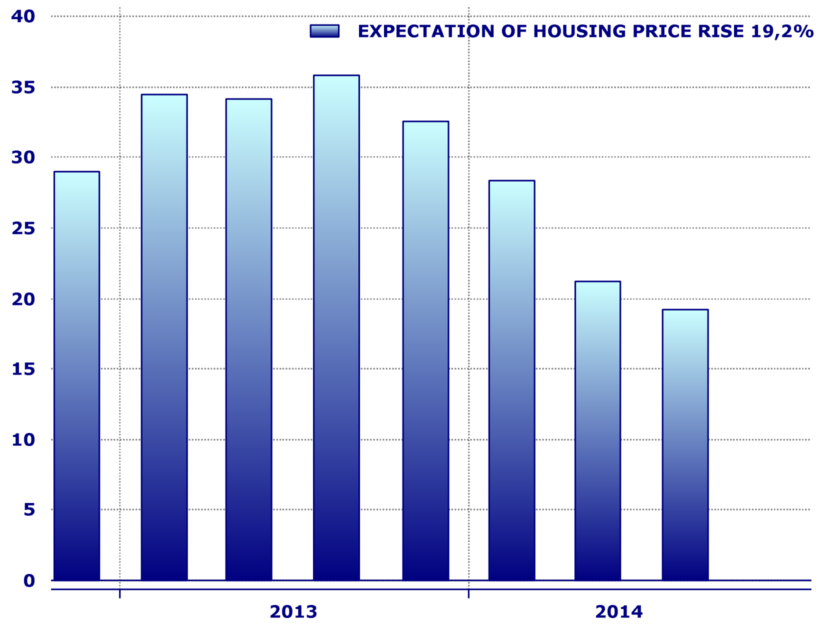
REAL ESTATE MARKET

The correction on real estate market is evident on sales' volumes and prices of new buildings and on the secondary market. PBoC survey highlighted for this year that those who expect a rise in housing prices is following a downward trend.

REAL ESTATE MARKET: PRICES



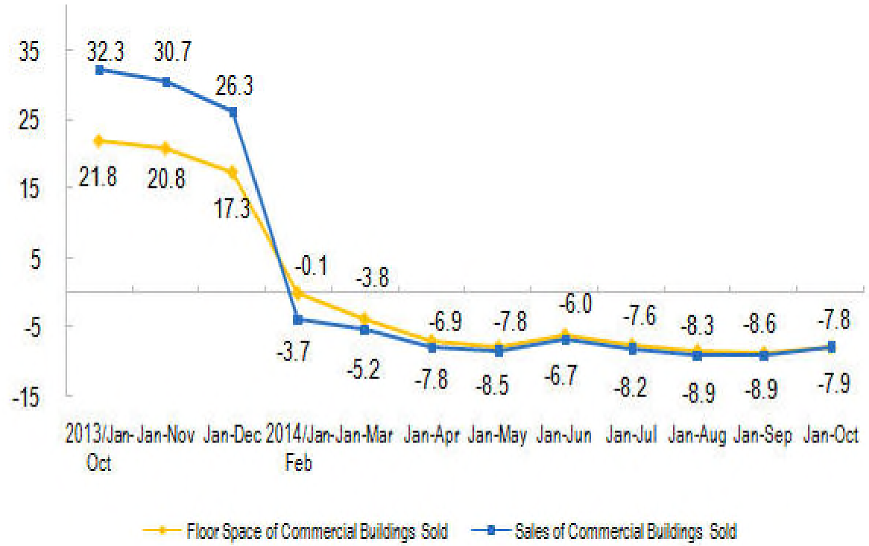
REAL ESTATE MARKET: COMMERCIAL SALES



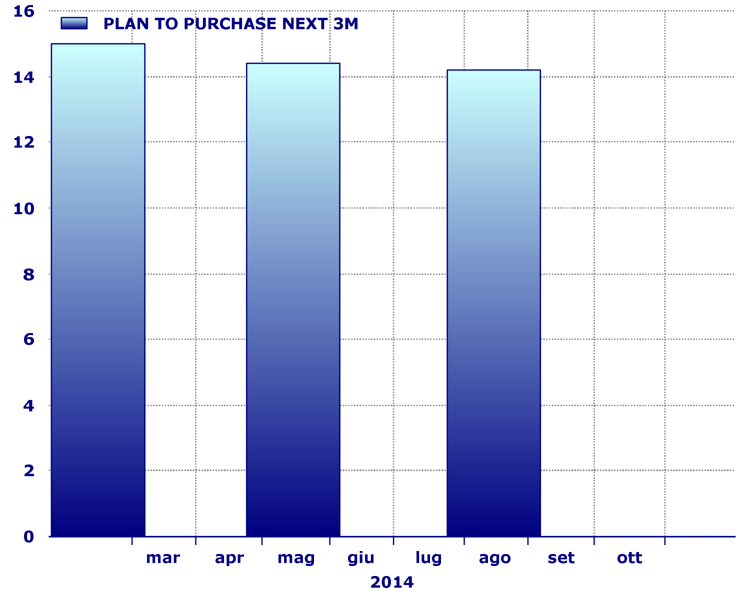
REAL ESTATE MARKET

According to PBoC' survey, those who plan to purchase in the next three months have gradually decreased, suggesting that the negative sales' trend will last for the coming months.

REAL ESTATE MARKET:
COMMERCIAL SALES



REAL ESTATE MARKET:
PLAN TO PURCHASE IN THE COMING THREE MONTHS



REAL ESTATE MARKET

The adjustment may take longer than in the past, due to excess capacity, combined with slowdown in urbanization rate, despite the reform on "hukou", that originally granted welfare only in one's birthplace.

2007-2009

- The Government has created a series of measures to restrict real estate investments, including seven interest rate increases and requested reserves, restrictions on land acquisitions and tax increases on profits from real estate investments.

2011-2012

- The Government has introduced restrictive measures on real estate acquisitions in 40 cities and has put into effect restrictive monetary measures.

2014

- The Government has gradually removed obstacles for buying real estate, giving tax breaks for housing and promoting liquidity injections from the Central Bank.

- The hokou reform has cancelled the differences between urban and rural population migrated to the cities, permitting access to services to all. The original measure wanted to strengthen farmers' bonds with their territory and contain migration to cities.

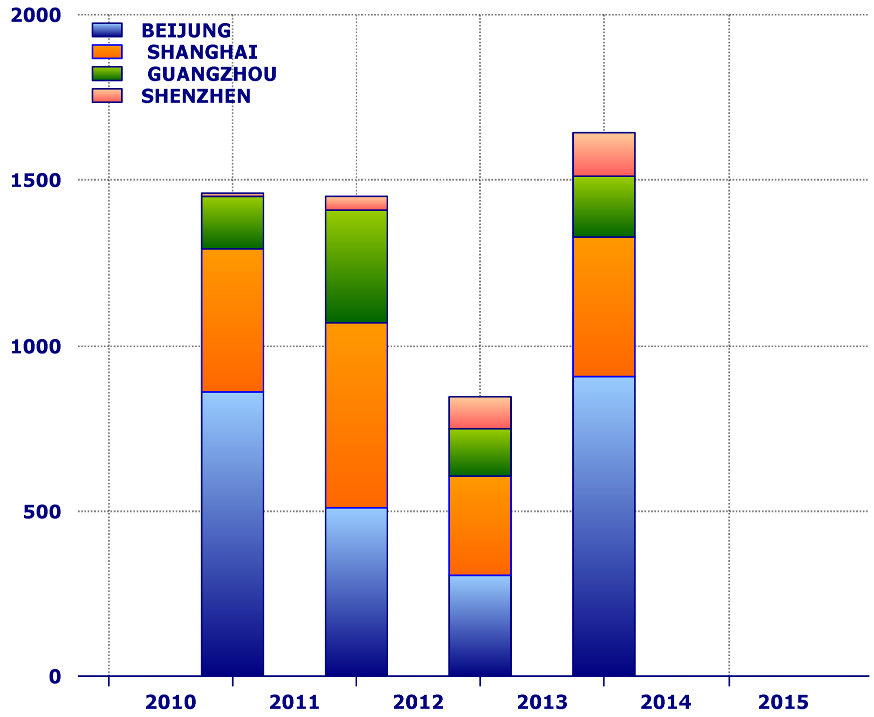
REAL ESTATE MARKET

- **Stock**: some studies affirm that two years will be needed to destock land acquisitions in 2010-2013 in the principal areas and for smaller cities between 4-6 years, according to the optimists, and 10-12 for others.

- **Urbanization rate:** after the strong acceleration in the 2000-2013 period, during which urbanization rate went from 36.2% to 53.7%, we expect a slowdown in migration from rural to urban areas. The hukou reform will serve more as a social stabiliser than as an incentive to migrate.

- **Estimates:** estimating demand from migration flows towards cities, and from existing population, we obtain a demand of 9.84 bn square meters, significantly lower than supply (around 14 bn sq. m).

REAL ESTATE MARKET:
LAND SOLD IN PRINCIPAL CITIES (10-1000 MQ)



BANCA ALETTI

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